

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



June 26, 2003

Agenda ID #2439

Agenda ID #2356

TO: PARTIES OF RECORD IN APPLICATIONS (A.) 02-05-022, A.02-05-025,
A.02-05-026 AND A.02-05-031

Enclosed herewith are two documents. The first document is the draft decision (DD) of Administrative Law Judge (ALJ) Galvin. The second document is the alternate draft decision (ADD) of Commissioner Loretta Lynch.

Each of these items will appear on the Commission's agenda for July 10, 2003. The Commission may act then, or it may postpone action until later. When the Commission acts, it may adopt all or part of the DD or ADD as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

As set forth in Rule 77.6(d), parties to the proceeding may file comments on the enclosed alternate by July 7, 2003. An original and four copies of the comments with a certificate of service shall be filed with the Commission's Docket Office and copies shall be served on all parties on the same day of filing. The Commissioners and ALJ shall be served separately by overnight service.

/s/ ANGELA MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:epg

Enclosures

COM/LYN/epg

ALTERNATE DRAFT

Agenda ID # 2439

**Alternate to Agenda ID # 2356
Ratesetting**

Decision ALTERNATE DRAFT DECISION OF COMMISSIONER LYNCH
(Mailed 6/26/2003)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company
for Authority to Establish Its Authorized rates of
return on Common Equity for Electric Utility
Operations and Gas Distribution for Test Year
2003. (U 39 M)

Application 02-05-022
(Filed May 8, 2002;
Petition for Modification
filed April 1, 2003)

And Related Matters.

Application 02-05-025
Application 02-05-026
Application 02-05-031

**ALTERNATE ORDER OF COMMISSIONER LYNCH GRANTING WITH
CHANGES SOUTHERN CALIFORNIA EDISON COMPANY'S
PETITION TO MODIFY DECISION 02-11-027**

I. Summary

This order exempts Southern California Edison Company (SCE) from filing a 2004 test year cost of capital (COC) application. SCE's return on equity (ROE) shall be reduced from the prior adopted level of 11.6% to 11.22%, consistent with the ROE most recently adopted for Pacific Gas and Electric Company (PG&E).

SCE's next COC application shall be for its 2005 test year and shall be filed by May 10, 2004.¹

II. Background

SCE is required to file a test year COC application on May 8 of each year, pursuant to D.89-01-040.² Consistent with that requirement, SCE filed its 2003 test year COC application on May 8, 2002. By D.02-11-027, dated November 7, 2002, SCE was authorized an 11.60% COC for its 2003 test year based on a capital structure of 47.00% long-term debt, 5.00% preferred stock, and 48.00% common stock. Its 2004 test year COC filing date has been postponed until July 8, 2003 pending resolution of the petition before us.³

III. Petition

On April 1, 2003, SCE filed a petition to modify D.02-11-027 to allow it to forego a 2004 test year COC application. SCE seeks this exemption on the basis that there has been no material change in its financial circumstances or in bond interest rates since the completion of its 2003 test year COC proceeding.

SCE provided several reasons for its request. As detailed in the May 2, 2003 supplement to its petition, SCE's capital structure remains the same as its adopted 2003 test year COC and its debt and preferred stock issuances retain the

¹ Although Decision (D.) 89-01-040 provides for COC applications to be filed by May 8 of each year, that date falls on a Saturday in 2004. Pursuant to Rule 3.2 of the Commission's Rules of Practice and Procedure (Rules), its 2005 test year application should be due on the first business day following May 8.

² 30 CPUC 2d 576 at 610 (1989).

³ Executive Director's April 8, 2003 letter issued pursuant to Rule 48(b).

non-investment grade ratings that existed during that test year COC proceeding.⁴ Those same rating agencies have found SCE's financial recovery to be heavily dependent on resolution of PROACT balancing account issues under review by the California Supreme Court.⁵ Finally, interest rate projections have not changed materially since its last COC proceeding. For example, the interest rate projection during the 2003 test year proceeding was 7.16% in November of 2002 compared to 7.28% in April of 2003, a nonmaterial twelve basis points differential.⁶

IV. Discussion

On April 24, 2003, the Office of Ratepayer Advocates (ORA) filed a response supporting SCE's petition on the basis that SCE's COC may be more accurately measured and determined when the uncertainty surrounding the electric crisis has been reduced; ORA also asserts that Commission resources are better directed to regulatory matters other than COC in 2004.⁷ No other responses were filed.

With no opposition to SCE's petition and the status quo of SCE's capital structure and credit ratings and nominal change in long-term interest rates, there

⁴ Investment grade commonly means that a company's debt or preferred stock carries a BBB- or better rating from Standard & Poor's and a Baa3 or better rating from Moody's Investors Service. SCE's ratings have remained unchanged since March of 2002.

⁵ See Application (A.) 02-05-022 et al., Exhibit 34, pp. 70-73. Although the Commission is considering the transfer of SCE's uncollected PROACT balance to an Energy Resource Recovery Account in A.03-01-019, that proceeding does not resolve the PROACT issues before the California Supreme Court.

⁶ One basis point equals 0.01%.

⁷ ORA's response at 2.

is no useful purpose being served by requiring SCE to file a 2004 test year COC application at this time. SCE's petition to defer a review of its cost of capital should be granted.

However, the current level of return that SCE is allowed to earn on its equity is not based on economic and financial circumstances of a year ago. Unlike PG&E and San Diego Gas and Electric Company (SDG&E), SCE's adopted 2003 ROE of 11.6% was based on a seven year old set of assumptions and methodology. SCE has had since November 1996 an ROE of 11.6%, due to the adoption of a mechanism that froze SCE's ROE at 11.6% unless certain interest rates changed beyond preset bounds. This "trigger" mechanism was in place for 2003, and was a primary factor in setting SCE's test year 2003 return on equity at 11.6%, a level higher than PG&E's or SDG&E's.

However, that trigger mechanism expires at the end of 2003, and thus has no bearing on what the adopted ROE for SCE should be in 2004. The fact that financial and economic circumstances have remained largely unchanged over the last year, is not a sufficient basis for concluding that SCE's ROE should remain at the current level of 11.6%. The issue for the Commission to consider in setting SCE's ROE for 2004 is whether, ***absent the trigger mechanism***, SCE's ROE should be consistent with the levels adopted for SDG&E and PG&E, or should it continue to reflect the 1997 return on equity of 11.6%, as if the trigger mechanism were still in place.

Since SCE and ratepayers have been anticipating that the trigger mechanism would cease to apply at the end of 2003, it would be unfair to ratepayers and inconsistent with the prior Commission decisions to continue the 11.6% ROE for 2004 as if the trigger mechanism still was still in effect. As SCE has indicated in its petition, little else has changed in regards to economic and

financial conditions since last year. Thus, an appropriate ROE for SCE for 2004 can be derived by reviewing the record in last year's cost of capital proceeding.

As specified in D. 02-11-027, the reasonable range of values of ROE for SCE were the same as for PG&E, 10.80% to 11.80%, slightly higher than the reasonable range for SDG&E of 10.50% to 11.50%. The trigger mechanism was a prime determinant for setting SCE's 2003 ROE at a level above that adopted for PG&E, not other financial differences between the two utilities. With the expiration of SCE's trigger mechanism, an appropriate ROE for SCE would be the same as adopted for PG&E, 11.22%. This is well within the range of reasonable values specified in D. 02-11-027, and is significantly higher than the 10.90% ROE adopted for SDG&E.

V. Comments on Alternate Draft Decision

This is an uncontested matter in which the decision grants the relief requested. The alternate draft decision of Commissioner Loretta Lynch was mailed to the parties on June 26, 2003 in accordance with Rule 77.6(d) of the Rules of Practice and Procedure. Comments on the Alternate Draft Decision of Commissioner Lynch is due on July 7, 2003.

VI. Assignment of Proceeding

Geoffrey F. Brown and Michael R. Peevey are the Assigned Commissioners and Michael J. Galvin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE seeks authority to forego its 2004 test year COC application.
2. SCE's 2004 test year COC application is scheduled to be filed on July 8, 2003.
3. SCE's capital structure remains the same as its adopted 2003 test year COC.

4. SCE's debt and preferred stock issuances retain non-investment grade credit ratings that existed during its 2003 test year COC proceeding.

5. The rating agencies have found SCE's financial recovery to be heavily dependent on resolution of PROACT balancing account issues currently under review by the California Supreme Court.

6. Interest rate projections during the 2003 test year COC proceeding have not changed materially.

7. The trigger mechanism which had applied to SCE's return on equity since 1997 expires at the end of 2003, and is irrelevant to SCE's 2004 return on equity.

8. Use of 2003 test year COC assumptions and information, absent the trigger mechanism, support a rate of return on equity between the 10.90 % approved for SDG&E and the 11.22% adopted for PG&E.

9. ORA concurs with SCE's petition.

10. There is no filed opposition to SCE's petition.

Conclusions of Law

1. SCE's unopposed petition to defer a proceeding to review SCE's COC should be approved because it has demonstrated that there has been no material change in its financial circumstances or in bond interest rates since the completion of its 2003 test year COC proceeding.

2. Based on the unchanged 2003 test year COC information, an appropriate ROE for SCE is between 10.90% and 11.22%

3. This decision should be effective today, in order to allow the docket to be closed expeditiously.

IT IS ORDERED that:

1. Southern California Edison Company (SCE) is exempt from filing a 2004 test year cost of capital (COC) application.

2. SCE shall file a 2005 test year COC application by May 10, 2004.
3. SCE's return on equity shall be reduced from 11.6% to 11.22%, reflecting unchanged test year 2003 assumptions and the expiration of SCE's trigger mechanism at the end of 2003.
4. Application (A.) 02-05-022 remains open for the receipt and resolution of an amended application requesting a true up Pacific Gas and Electric Company's 2003 test year COC.
5. A.02-05-025, A.02-05-026, and A.02-05-031 are closed.

This order is effective today.

Dated _____, at San Francisco, California.

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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for Authority to Establish Its Authorized rates of
return on Common Equity for Electric Utility
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**ORDER GRANTING SOUTHERN CALIFORNIA EDISON COMPANY'S
PETITION TO MODIFY DECISION 02-11-027**

I. Summary

This order exempts Southern California Edison Company (SCE) from filing a 2004 test year cost of capital (COC) application. SCE's next COC application shall be for its 2005 test year and shall be filed by May 10, 2004.⁸

⁸ Although Decision (D.) 89-01-040 provides for COC applications to be filed by May 8 of each year, that date falls on a Saturday in 2004. Pursuant to Rule 3.2 of the Commission's Rules of Practice and Procedure (Rules), its 2005 test year application should be due on the first business day following May 8.

II. Background

SCE is required to file a test year COC application on May 8 of each year, pursuant to D.89-01-040.⁹ Consistent with that requirement, SCE filed its 2003 test year COC application on May 8, 2002. By D.02-11-027, dated November 7, 2002, SCE was authorized an 11.60% COC for its 2003 test year based on a capital structure of 47.00% long-term debt, 5.00% preferred stock, and 48.00% common stock. Its 2004 test year COC filing date has been postponed until July 8, 2003 pending resolution of the petition before us.¹⁰

III. Petition

On April 1, 2003, SCE filed a petition to modify D.02-11-027 to allow it to forego a 2004 test year COC application. SCE seeks this exemption on the basis that there has been no material change in its financial circumstances or in bond interest rates since the completion of its 2003 test year COC proceeding.

SCE provided several reasons for its request. As detailed in the May 2, 2003 supplement to its petition, SCE's capital structure remains the same as its adopted 2003 test year COC and its debt and preferred stock issuances retain the non-investment grade ratings that existed during that test year COC proceeding.¹¹ Those same rating agencies have found SCE's financial recovery to be heavily dependent on resolution of PROACT balancing account issues under

⁹ 30 CPUC 2d 576 at 610 (1989).

¹⁰ Executive Director's April 8, 2003 letter issued pursuant to Rule 48(b).

¹¹ Investment grade commonly means that a company's debt or preferred stock carries a BBB- or better rating from Standard & Poor's and a Baa3 or better rating from Moody's Investors Service. SCE's ratings have remained unchanged since March of 2002.

review by the California Supreme Court.¹² Finally, interest rate projections have not changed materially since its last COC proceeding. For example, the interest rate projection during the 2003 test year proceeding was 7.16% in November of 2002 compared to 7.28% in April of 2003, a nonmaterial twelve basis points differential.¹³

IV. Discussion

On April 24, 2003, the Office of Ratepayer Advocates (ORA) filed a response supporting SCE's petition on the basis that SCE's COC may be more accurately measured and determined when the uncertainty surrounding the electric crisis has been reduced; ORA also asserts that Commission resources are better directed to regulatory matters other than COC in 2004.¹⁴ No other responses were filed.

With no opposition to SCE's petition and the status quo of SCE's capital structure and credit ratings and nominal change in long-term interest rates, there is no useful purpose being served by requiring SCE to file a 2004 test year COC application at this time. SCE's petition should be granted.

V. Comments on Draft Decision

This is an uncontested matter in which the decision grants the relief requested. Therefore, the applicable 30-day period for public review and

¹² See Application (A.) 02-05-022 et al., Exhibit 34, pp. 70-73. Although the Commission is considering the transfer of SCE's uncollected PROACT balance to an Energy Resource Recovery Account in A.03-01-019, that proceeding does not resolve the PROACT issues before the California Supreme Court.

¹³ One basis point equals 0.01%.

¹⁴ ORA's response at 2.

comment is being waived pursuant to Section 311(g)(2) of the Public Utilities Code.

VI. Assignment of Proceeding

Geoffrey F. Brown and Michael R. Peevey are the Assigned Commissioners and Michael J. Galvin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

6. SCE seeks authority to forego its 2004 test year COC application.
7. SCE's 2004 test year COC application is scheduled to be filed on July 8, 2003.
8. SCE's capital structure remains the same as its adopted 2003 test year COC.
9. SCE's debt and preferred stock issuances retain non-investment grade credit ratings that existed during its 2003 test year COC proceeding.
10. The rating agencies have found SCE's financial recovery to be heavily dependent on resolution of PROACT balancing account issues currently under review by the California Supreme Court.
11. Interest rate projections during the 2003 test year COC proceeding have not changed materially.
12. ORA concurs with SCE's petition.
13. There is no filed opposition to SCE's petition.

Conclusions of Law

4. SCE's unopposed petition should be approved because it has demonstrated that there has been no material change in its financial circumstances or in bond interest rates since the completion of its 2003 test year COC proceeding.

5. This decision should be effective today, in order to allow the docket to be closed expeditiously.

IT IS ORDERED that:

14. Southern California Edison Company (SCE) is exempt from filing a 2004 test year cost of capital (COC) application.

15. SCE shall file a 2005 test year COC application by May 10, 2004.

16. Application (A.) 02-05-022 remains open for the receipt and resolution of an amended application requesting a true up Pacific Gas and Electric Company's 2003 test year COC.

17. A.02-05-025, A.02-05-026, and A.02-05-031 are closed.

This order is effective today.

Dated _____, at San Francisco, California.